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No. ~~824~~

In the Supreme Court of the United States

OCTOBER TERM, 1970

M.F.A. CENTRAL COOPERATIVE, ET AL., PETITIONERS

v.

EDWIN O. BOOKWALTER, DISTRICT DIRECTOR OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

ERWIN N. GRISWOLD,
Solicitor General,
Department of Justice,
Washington, D.C. 20530.

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Petitioners are cooperative agricultural associations which own shares in the St. Louis Bank for Cooperatives. The St. Louis Bank is one of twelve such regional banks, each located within a particular farm district. In addition, there is a central bank in Washington. (Pet. App. C, pp. 9a–10a).

The Banks for Cooperatives were originally established by the Farm Credit Act of 1933, c. 785, 69 Stat. 655, to accomplish three congressional objectives: (1) to substitute borrower capital for the government's initial capitalization of the banks; (2) to establish a mechanism by which borrower cooperatives could

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obtain increasing management, ownership and control of the banks; and (3) to pattern the banks' organization and operation after the "revolving fund" capitalization typical to cooperatives. See Farm Credit Act of 1953, c. 335, 67 Stat. 390, Section 2; S. Rep. No. 1201, 84th Cong., 1st Sess. pp. 1, 5–6.

The 1955 Act provides that the regional banks may issue three classes of stock. Class A stock represents the original capital contribution by the United States. It is non-voting, does not pay a dividend, and is to be retired at par according to a method which depends upon the amount of Class C stock purchased by cooperatives such as petitioners and upon the banks' net profits. Class B stock may be sold to any person, is nonvoting, and may pay a dividend not in excess of four percent. Class C stock is, in effect, the voting, common stock of the banks. The stock pays no dividends, and a shareholder of Class C stock is entitled to one vote, regardless of the number of shares of stock it owns. (Pet. App. C, pp. 10a–11a.)

The 1955 Farm Credit Act provides that cooperatives may acquire Class C stock in three ways. First, each cooperative is required to purchase one share of Class C stock at its $100 par value to be eligible to borrow. Second, each borrower is required to invest, quarterly, a specified amount in Class C stock. The amount to be invested is determined by each regional bank's board of directors, and is based on a percentage (not less than 10 percent nor more than 25 percent) of the interest payable by each borrower cooperative for that quarter. Third, Class C stock is

distributed to cooperatives as a distribution of the net profits of a regional bank, in which form they are referred to as "patronage dividends." The amount of the patronage dividend is that percentage of the bank's net profits which the interest earned on the borrower's individual loan bears to the total interest earned on the loans to all borrowers during that fiscal year. (Pet. App. C, pp. 10a–11a, 20a.).

Each of the petitioner cooperatives owned one eligibility share of Class C stock in the St. Louis Bank (Pet. 4, n. 2). Each also purchased additional shares of Class C stock in the Bank in connection with its loans from the Bank in the years in issue (Pet. App. C, p. 11a). And each received shares of Class C stock as patronage dividends in those years (Pet. App. C., pp. 19a–20a). Only the tax treatment of the additional Class C stock acquired in connection with loans is here in dispute.

The precise issue is whether petitioners' investments in such Class C stock were expenditures for capital assets within the meaning of Section 1221 of the Internal Revenue Code of 1954, or whether such expenditures were currently deductible business or interest expenses under Section 162 or 163 of the Code.

The district court held that petitioners' payments for Class C stock purchased in connection with the loans were not interest under Section 163, but were ordinary and necessary business expenses under Section 162 (Pet. App. C, pp. 13a–19a). On the government's appeal, the Eighth Circuit reversed, holding

that petitioners' payments for Class C stock were not deductible because the stock constituted a capital asset within the meaning of Section 1221.

In *Penn Yan Agway Cooperative, Inc.* v. *United States*, 417 F. 2d 1372 (Ct. Cl.), and *Mississippi Chemical Co.* v. *United States*, 1970–2 U.S.T.C., para. 9601 (C.A. 5), decided September 14, 1970, the Court of Claims and the Fifth Circuit considered the identical question with respect to purchases of the Class C stock of the Springfield, Massachusetts, and New Orleans Banks for Cooperatives. Those courts did not pass directly on the question whether the payments were deductible under Section 162, but held—directly contrary to the decision in the instant case—that the payments were deductible under Section 163.[1]

The question of statutory interpretation raised—whether Class C stock purchased in connection with Bank for Cooperatives loans is a capital asset within the meaning of Section 1221—involves a substantial amount of revenue and affects a large number of cooperative taxpayers. It also is important because uniform tax treatment of Class C stock is necessary for the proper administration of the congressionally established Banks for Cooperatives system.

[1] In *Penn Yan Agway*, the Court of Claims found that the stock, purchased at its par value of $100 per share, had a market value of $7 per share; it permitted an interest deduction for the remaining $93. In *Mississippi Chemical* the entire purchase price of the stock beyond a nominal value of $1 per share was held deductible. In the instant cases petitioners sought to deduct the entire purchase price.

In view of the conflict among the courts of appeals and the Court of Claims, a settled rule can be established only through review by this Court. Accordingly, we join in urging that the petition be granted.

Respectfully submitted.

ERWIN N. GRISWOLD,
Solicitor General.

DECEMBER 1970.

The government will shortly file a petition for a writ of certiorari in *Mississippi Chemical*, copies of which will be served on counsel for petitioners herein. That petition, however, might not be reached in the ordinary course in time for argument this Term. In view of the need for prompt resolution of the conflict that has developed, we respectfully suggest that the Court not suspend action on the petition in the instant case until filings in *Mississippi Chemical* have been completed.

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